

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF DELTA NATURAL)	
GAS COMPANY, INC. FOR AN ORDER)	
AUTHORIZING THE PURCHASE OF)	CASE NO.
ALL OF THE ISSUED AND OUTSTANDING)	97-140
STOCK OF THE TRANEX CORPORATION)	

O R D E R

On August 11, 1997, the Commission granted rehearing on the issue of the regulatory accounting treatment accorded the TranEx Corporation ("TranEX") acquisition by Delta Natural Gas Company, Inc. ("Delta"). Delta was ordered to provide certain information regarding its proposed accounting treatment for the TranEx acquisition as a part of the Order granting rehearing. Delta filed the requested information on August 22, 1997. A hearing on this issue was not requested.

Delta proposes to record on TranEx's Balance Sheet an Intangible Asset reflecting the market value of an operating lease held by TranEx. Delta states that its proposed methodology is in accordance with Accounting Principles Board Opinion No. 16, Accounting for Business Combinations, ("APB16") and is therefore appropriate for recording this purchase. Delta further states that in recording the transaction as it proposes, it is not attempting to capitalize the operating lease.

The Commission stated in its original Order that, "the Uniform System of Accounts Prescribed for Natural Gas Utilities ("USoA") states in part that, "Changes in estimates . . . or changes in circumstances. . . shall not give rise to a new classification of a lease for

accounting purposes. . . ." Delta's proposed accounting treatment results in the booking of an intangible asset whose substance and value is derived by calculating the present value of the future cash inflows to be received from an existing operating lease. This methodology is the same as that which is used when booking a lease in accordance with the capital lease provisions contained in Statement of Financial Accounting Standard No. 13, Accounting for Leases. The substance of the transaction as proposed by Delta is that the previously unbooked operating lease is appearing on the utility's books in the form of an intangible asset. This would appear to conflict with the USoA prohibition against changing the character of a lease simply due to a change in an unrelated circumstance. The change in the stock ownership of TranEx does not in and of itself change the character of the existing operating lease of the TranEx assets.

The Commission takes note of the unique situation that resulted in the recording of the transaction as proposed by Delta including the fact that TranEx was, prior to this transfer, a Subchapter S corporation. The Subchapter S election allowed the previous owners to enjoy certain tax benefits that absent such election would have remained on the utility's books in the form of deferred taxes that would have been returned to the ratepayers over time. According to Delta, it was because of the seller's potential exposure to taxable gains on the sale, that it agreed to make an election under Section 338 of the Internal Revenue Code of 1986, as amended with respect to the purchase of TranEx.

Recording the transaction as proposed by Delta results in a credit plant acquisition adjustment which reduces the net utility plant in service. This would offset the loss of the tax benefits that resulted from the Subchapter S election. Due to these unique circumstances, and Delta's assertion that it is not attempting to change the character of the

existing operating lease, the Commission finds that the accounting treatment proposed by Delta on rehearing is acceptable for regulatory accounting purposes. The Commission further finds that Delta should record the intangible asset in Account No. 174, Miscellaneous Current and Accrued Assets and should amortize the accrued asset over the original term of the lease and that the acquisition adjustment should be amortized over the remaining life of the utility plant

The Commission takes note of Delta's statements in its rehearing motion regarding the treatment of the acquisition adjustment for rate-making purposes. The Commission reminds Delta that the issue of inclusion or exclusion of any acquisition adjustment in the rate base or expenses of the utility for rate-making purposes can only be addressed in a rate case. Therefore, the findings herein relate only to approved regulatory accounting for the transaction and not rate treatment.

IT IS THEREFORE ORDERED that:

1. Within 30 days of the date of this Order, Delta shall file the journal entries made on its books as well as on the books of TranEx to effect the transaction in accordance with the Uniform System of Accounts Prescribed for Natural Gas Utilities and the Commission's findings herein.
2. All other provisions and requirements set forth in the Commission's June 27, 1997 Order shall remain in full force and effect.

Done at Frankfort, Kentucky, this 17th day of October, 1997.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director